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Illinois Commerce Commission
On Its Own Motion

-vs-

Central Illinois Light Company

Reconciliation of revenues collected
under gas adjustment charges with
actual costs prudently incurred.

Docket No. 00-0710

**INITIAL BRIEF ON BEHALF OF
CENTRAL ILLINOIS LIGHT COMPANY**

Now comes Central Illinois Light Company ("CILCO" or "the Company"), and pursuant to the schedule established by the Administrative Law Judge at the close of the evidentiary hearings, hereby submits its Initial Brief in the above-captioned proceeding.

I. INTRODUCTION --

Pursuant to the Commission's Order initiating this proceeding, CILCO submitted testimony and exhibits supporting the recovery of \$168,120,641 of Gas Costs through its Purchased Gas Adjustment (PGA) clause. CILCO's recoverable gas costs consisted of the Gas Commodity portion of \$156,133,192 (CILCO Ex. 1.1, Sch. 1, line 11), and the Non-Commodity (e.g., transportation and storage) portion of \$12,243,460 (CILCO Ex. 1.2, Sch. 1, line 5), and were offset by pipeline refunds of Take-or-Pay Costs of \$256,011 (CILCO Ex. 1.3, Sch. 1, line 5). Staff proposed three small adjustments that would reduce CILCO's recoverable gas costs by \$72,100, and recommended the Commission accept the balance of CILCO's costs representing in excess of 99.999% of CILCO's total gas costs. Staff Ex. 1.0, p.8. In addition, Staff proposed an adjustment

to correct a minor mathematical error, which would increase CILCO's recoverable gas costs by \$29,100. CILCO accepted Staff's proposed correction of the math error and chose not to contest two of the three reductions proposed by Staff. The only outstanding issue to be resolved by the Commission involves Staff's proposal to reclassify management fee revenues to offset the recoverable cost of gas charges by \$49,120. See Staff Ex. 1.0, p. 3, Schedule 2, p. 2, col. (F).

Staff's proposed reclassification of management fees is inconsistent with the Commission Rule governing CILCO's PGA clause, which is designed to match gas charges with gas costs paid to pipelines and wholesale gas suppliers. None of the costs associated with these management fee transactions have been recovered through the PGA, and the fees are distinct from revenues that result from transactions with separate charges for the sale of gas volumes. 83 Illinois Administrative Code Section 540.25(d) requires that revenues offset recoverable gas costs only if "any of the associated costs are recoverable gas costs as prescribed by subsection [540.25] (a)," which basically describes them as costs paid to pipelines and gas suppliers. Staff's approach would mismatch gas supply costs and PGA charges by reducing PGA charges by revenues received for services other than the sale of the gas commodity without including all the costs of those services. It makes no sense for CILCO to continue to offer these services to non-jurisdictional customers if the Company receives no income for the services. Without the added benefits of the management services CILCO provides, these customers are likely to purchase gas supplies elsewhere as well. CILCO has credited the PGA for revenues in excess of gas cost for sales of gas commodities to the non-jurisdictional customers who also receive management service for a separate charge. Staff's

misapplication of the PGA clause rule would effectively deprive PGA customers of the financial benefits received from sales of gas not subject to the PGA.

II. FACTS -

CILCO has entered into contracts with non-jurisdictional customers to provide services related to the management of the customers gas supplies. The management fees are charged because CILCO provides management services, including but not limited to, pricing and pipeline rate analysis, daily and monthly pipeline balancing, nominations, scheduling and metering. CILCO Ex. 3.0 (Rev.), p. 2. The services also included parking transactions whereby customer-owned gas is delivered to the CILCO city gate and subsequently redelivered to the customer (Tr. 73), which requires CILCO employees to verify receipt availability, perform nominations and calculate fuel loss. In one instance, the customer's meter was added to CILCO's SCADA system, which is constantly monitored by CILCO's Gas Control department. The charges for these services are not regulated, and the customers could obtain these services from a service provider other than CILCO. Where CILCO provides gas supplies to these customers, the contracts contain a separate, identifiable charge for the volumes of gas supplied (CILCO Ex. 5.0, p. 2; Tr. 108), and the charges provide a margin in excess of an indexed gas price. ICC Staff Ex. 3.1; Staff Cross Ex. 2. When CILCO supplies natural gas volumes to these customers, the revenues collected from the separate charge for supplying the commodity are credited to the PGA. In the case of one customer, these offsetting revenues provided a benefit to CILCO customers in the form of a reduction in gas charges through

the PGA amounting to approximately \$42,000 in the year 2000. Tr. 64-65; CILCO Ex. 3.0 (Rev.), p. 3, line 55; CILCO Ex. 5.0, p. 2.

None of the costs incurred by CILCO in providing the management fee services were paid to pipelines or gas suppliers. Tr. 108, 113. Nor were these costs recovered through the PGA. Tr. 96-97, 100; CILCO Ex. 3.0, p. 2. CILCO was not providing these services when the Company's base rates were last established. Tr. 69-70. Thus, expenditures such as the \$2,700 CILCO recently spent to set up its SCADA system, inspect the tap and adjust the meter for one customer in order to provide management services could not have been included in the revenue requirements used to establish CILCO's base rates. CILCO Ex. 5.0, p. 2. Entries from the CILCO accounting records that Staff used to determine the amount of management fees ("CILCO/CESI Margin") to reclassify shows that no volumes of gas were supplied in connection with management fee transactions with PG&E and CESI, and no other evidence was provided to show that any costs associated with these management fee dealings were recoverable gas costs that had been included in the PGA. Staff Cross Ex. 1; Tr. 71, 108, 113.

III. ARGUMENT -

The operative section of the Commission's Purchased Gas Adjustment Clause Rule, 83 Ill. Adm. Code Part 525 is Section 525.40(d), which provides:

Recoverable gas costs shall be offset by the revenues derived from transactions at rates that are not subject to the Gas Charge(s) if any of the associated costs are recoverable gas costs as prescribed by subsection (a) of this Section. This Subsection shall not apply to transactions subject to rates contained in tariffs on file with the Commission, or in contracts entered into pursuant to such tariffs,

unless otherwise specifically provided for in the tariff. Taking into account the level of additional recoverable gas costs that must be incurred to engage in a given transaction, the utility shall refrain from entering into any such transaction that would raise the Gas Charge(s).

Subsection (a) describes "recoverable gas costs" in terms that are essentially limited to payments made to third party pipelines and gas suppliers for the purchase of gas commodities, transportation and storage. CILCO fully complied with this section whenever it sold gas volumes to non-jurisdictional customers and included the gas costs in its PGA, by offsetting the cost of gas by the revenues derived from the sale of those gas volumes. CILCO's testimony showed that the revenues from actual gas sales to one such non-jurisdictional customer benefitted PGA customers by a \$42,000 reduction in gas costs included in the PGA. Tr. 64-65; CILCO Ex. 3.0 (Rev.), p. 3. Transactions with the other two non-jurisdictional customers did not involve the sale of any gas volumes. Tr. 71, 73, 113.

The management fees charged pursuant to the contracts with non-jurisdictional customers relate to transactions that are different from the gas sales transactions that are separately and clearly identified in the contracts. The costs that CILCO incurs to provide the management services are not paid to third-party pipelines or gas suppliers (Tr. 108) as the Rule contemplates as prerequisite to including the revenue from the transaction as an offset to recoverable gas costs. In other words, the management fee transactions under the contracts entail no gas costs that are included for recovery through CILCO's PGA clause, so there are no revenues from the transactions that need to be matched to such costs in accordance with the design of the PGA rule.

Staff's argument that the Rule requires the revenues from management fees to be credited to the PGA is based on two mistaken premises. First, Staff fails to distinguish between transactions and contracts. Staff reads the Section 525.45(d) as if the word "contracts" appears in place of "transactions." Tr. 101. Second, Staff mistakenly perceives that CILCO is recovering the costs of providing management services twice: once through its base rates, and again through the contract management fees. ICC Staff Ex. 3.0, p. 5.

Contrary to Staff's approach, Section 525.45(d) does not use the term "contracts" to describe the source of revenue that must be credited to the PGA. The Commission used the narrower term, "transactions," and presumably could have specified "contracts" had that been the Commission's intent. Staff construction would lead to absurd results. A contract can consist of numerous separate transactions. For example, CILCO's non-jurisdictional customer, the Village of Riverton, might prefer the convenience of entering into a master energy services agreement with CILCO that includes transactions such as the sale of electricity, provision of natural gas, and installation of conservation measures. Under Staff's "contracts" approach, all the revenue including the revenue derived from electric sale transactions and installation of energy conservation improvements would have to be credited through the PGA. Obviously, CILCO would not want to provide services at a loss. As a result, CILCO would not sell gas to this non-jurisdictional customer, thereby depriving the PGA customers of the benefit of the margin on such sales provided from the separate charge for the gas purchased.

Staff's other error concerns its misconception that CILCO is already being compensated for the costs of its management services through its base gas rates. ICC Staff Ex. 3.0,

p. 5. CILCO base gas rates were last established in 1993. At that time CILCO was not providing the aforementioned management services to non-jurisdictional customers, so none of the expenses associated with these service could have been included in the revenue requirements for the test year used in that proceeding. Tr. 69-70. At the time of CILCO's last base rate proceeding close to a decade ago, CILCO's rates were set at a level necessary to recover the costs of providing regulated gas delivery services to its jurisdictional customers. There is no indication whatsoever in this proceeding to suggest CILCO is no longer incurring that level of, or greater, costs to provide its regulated gas delivery services now, or that CILCO's base rates fully recover the expenses of its regulated services as well as the new management services provided pursuant to the contracts at issue in this case. Such a determination can only be properly made in a base rate proceeding. Staff's approach mixes base rate recovery issues with PGA recovery matters. The PGA was designed to provide for symmetrical treatment of gas charges and the cost paid to third parties to acquire the gas supplied. In that way the PGA provides customers with a true price signal for the cost of meeting regulated customers' gas supply needs. Staff advocates an asymmetrical approach by including only the revenues from management services fees, but leaving the recovery of the associated costs out Tr. 99-100, to be considered in a base rate proceeding. This one-sided application plainly conflicts with the matching principles that are at the root of the PGA Rule.

IV. CONCLUSION –

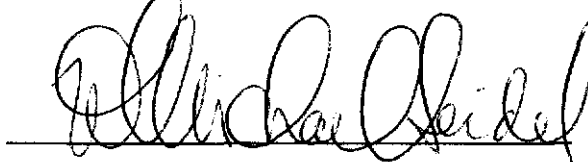
As explained above, Staff's proposed adjustment is inconsistent with 83 Ill. Adm. Code Section 540.25 and the purpose of the purchased gas adjustment clause, which is to provide

timely recovery of gas costs paid by the utility to pipelines and gas suppliers. The costs that CILCO incurs for its employees and investments to provide management services are not recovered through the PGA, and the revenues derived from such service likewise should only be properly considered in a base rate proceeding. Staff's adjustment would provide a very minor short-term reduction in the gas costs paid by jurisdictional customers for the year 2000, but ultimately the impact of Staff's misapplication of the Rule would be detrimental to economic welfare. Since Staff's approach precludes CILCO from retaining the revenue from providing these services, CILCO would have no incentive to continue incurring the costs necessary to provide these services, or to sell gas to these non-jurisdictional customers. Unregulated customers would lose the benefits of the management services that CILCO provided, and PGA customers would lose the benefits of reduced gas charges from the gas sales to non-jurisdictional customers. For all these reasons, the Commission should reject Staff's proposed adjustment.

Respectfully submitted,

CENTRAL ILLINOIS LIGHT COMPANY

By:

A handwritten signature in black ink, appearing to read "W. Michael Seidel", is written over a horizontal line.

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